Industry Canada Industrie Canada

# Micro-Economic Monitor

## Third Quarter 2002

Micro-Economic Analysis Directorate, Policy Sector, Industry Canada.
This document is based on data up to December 16 and is also available on the Internet at
http://strategis.ic.gc.ca/sc_ecnmy/mera/engdoc/04.html

Canada

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# Overview

# *Real GDP growth moderated in the third quarter*

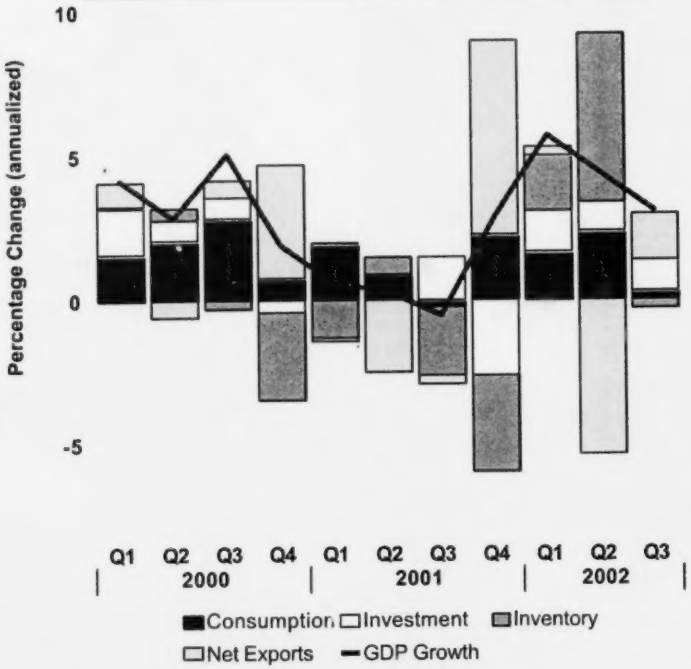
**Real Gross Domestic Product (GDP) rose by 3.1% (annualized) in the third quarter, down from 4.4% in the previous quarter. The Canadian economy enjoyed strong growth in 2002, averaging 4.4% in the first three quarters.**

**A moderation in consumer spending growth and smaller inventory investment slowed overall growth. Net exports were the largest contributor to growth. Residential investment rebounded sharply and investment in machinery and equipment rose further.**

**Recent indicators, particularly robust job creation in October and November, point to continued growth in the fourth quarter.**

**In the United States (U.S.) real GDP growth rebounded to 4.0% in the third quarter, from 1.3% in the previous quarter. Consumer spending growth, and car sales particularly, fueled U.S. growth. Continued weak employment conditions in October and November in the U.S., point to moderate growth in the fourth quarter.**

**Contributions to Quarterly Real GDP Growth* (Annualized)**




* For the purpose of simplification and given their relative stability over time, contributions from government expenditures are not shown.

Source: Statistics Canada

## *Canada is expected to lead the G-7 in 2002 and 2003*

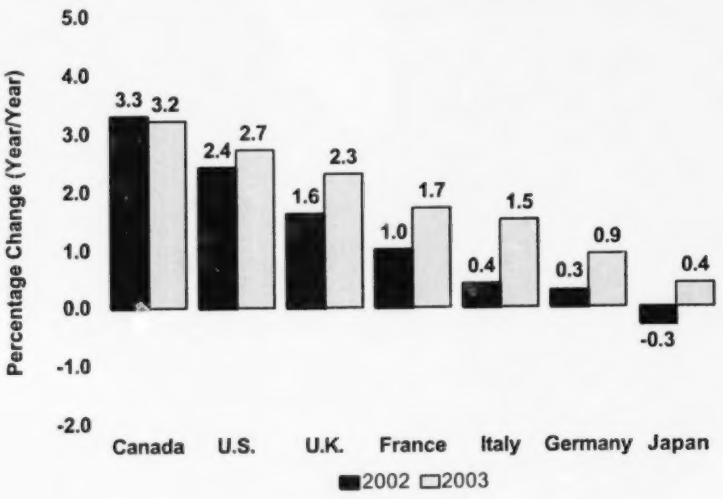
**Increased concern about geo-political turmoil in the Middle-East are dimming the G-7 growth outlook which was revised down somewhat relative to a few months ago. Canada is still expected to lead the G-7 in terms of growth in 2002 and 2003.**

**Global economic uncertainties have led major central banks to keep monetary conditions stimulative.**

- **The U.S. Federal Reserve lowered its Fed Funds rate by 50 basis points to 1.25% on November 6th and has since kept it at that level.**

- **The Bank of Canada has left its overnight rate at 2.75%.**

**Real GDP Growth Outlook**




Source: U.K. Consensus Forecasts, December 2002

# Domestic Scene

***Real Economic Activity***

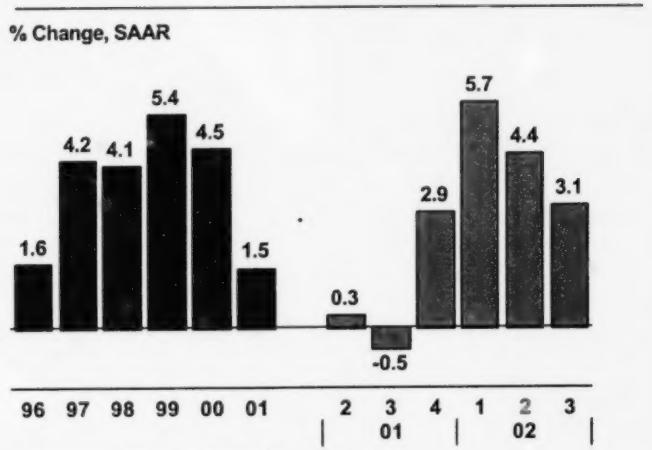
## *The economy slowed somewhat in the third quarter...*

**Real GDP increased at an annualized rate of 3.1% in the third quarter, after rising by 4.4% in the second quarter and 5.7% in the first quarter.**

- **Lower demand for consumer durables and declining investment in non-residential structures dragged down growth in the third quarter.**

- **Net exports contributed for half of real GDP growth, as exports benefited from strong U.S. demand. Residential investment surged and accounted for the bulk of investment growth.**

**Real GDP Growth**




Source: Statistics Canada

**Fueled by consumer spending and higher exports, U.S. real GDP grew 4.0% in the third quarter, up from 1.3% growth in the second. The Canadian economy has outperformed the U.S. economy in seven of the last ten quarters.**

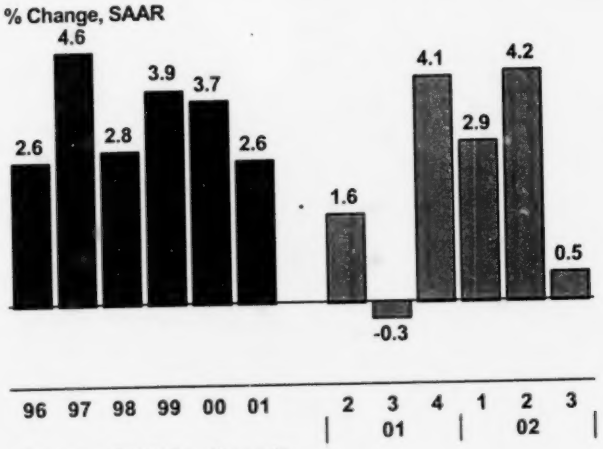
## *...as consumer spending growth slowed...*

**After three quarters of robust growth, consumer spending increased by a modest 0.5% in the third quarter.**

- **A 4.8% decline in durable goods spending accounted for a good part of the growth slowdown, as demand for motor vehicles went down. Purchases of cars remained at historically high levels nevertheless and durable goods spending was 4.5% higher than its 2001 level.**

- **Spending on services grew 1.9%, down from 6.7% in the second quarter, while spending on non-durables rose by 1.7% compared to 3.1% in the second quarter.**

**Real Consumer Expenditure Growth**

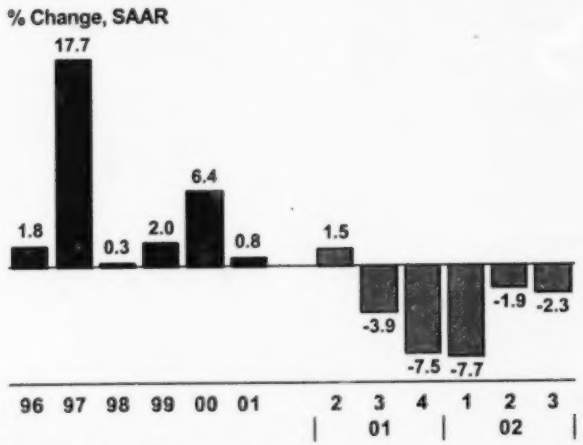



Source: Statistics Canada

## *...and non-residential construction remained weak*

**Non-residential construction continued to weaken in the third quarter, declining 2.3%. This represented the fifth consecutive quarterly decline.**

### Real Non-residential Construction Growth




Source: Statistics Canada

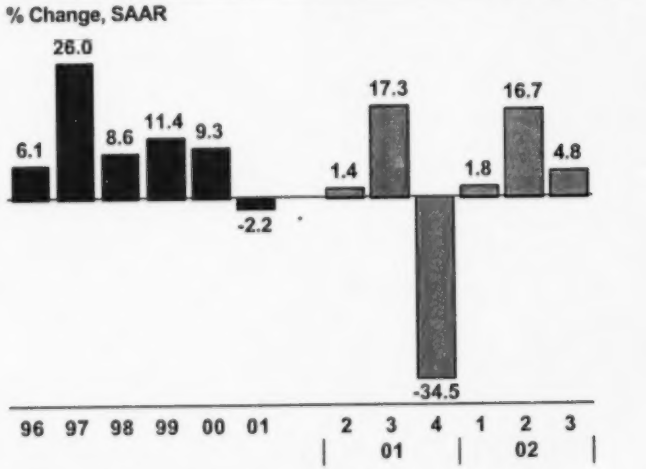
## *Investment in Machinery and Equipment growth moderated...*

**Business investment in Machinery and Equipment (M&E) rose 4.8% in the third quarter, following a 16.7% jump in the second quarter.**

- **Investment increases in cars, trucks and other transportation equipment were partially offset by a reduction in industrial machinery investment.**

- **Telecommunications equipment investment fell for the fifth consecutive quarter.**

**Real Machinery & Equipment Investment**




Source: Statistics Canada

## *...and inventory investment decreased*

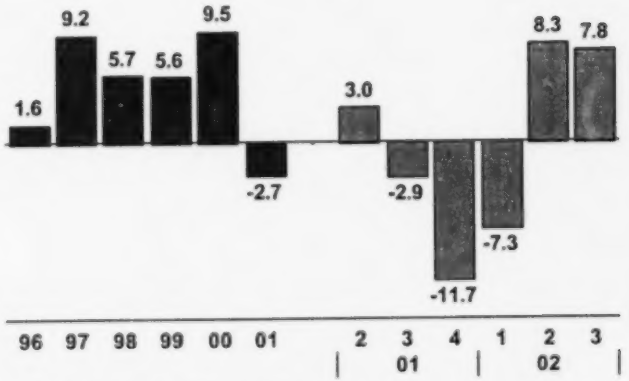
**Non-farm inventory accumulation slowed to $7.8 billion in the third quarter from $8.3 billion in the second quarter.**

- **Manufacturers, retailers and wholesalers rebuilt stocks, while motor vehicles stocks edged up in tandem with sales. However, farm inventories dropped, reflecting poor crops.**

**Businesses replenished their inventories in the last two quarters, but the inventory-to-sale ratio remained around 0.66, near a historically low level.**

### Non-farm Business Inventory Investment

$1997 Billion, SAAR




Source: Statistics Canada

## *Exports growth picked up in the third quarter...*

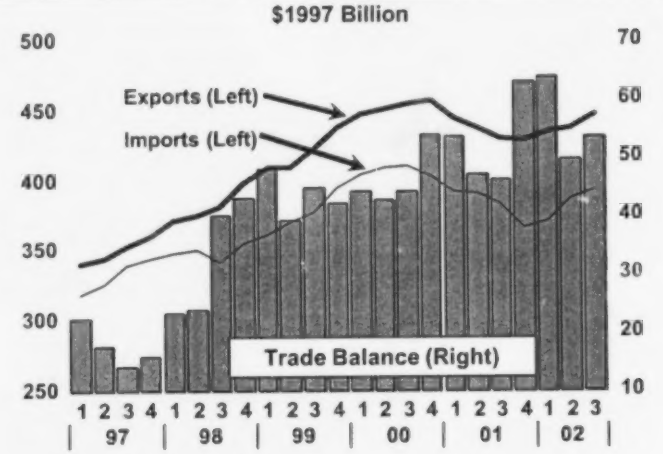
Real exports rose 9.6% in the third quarter, posting their highest gain in ten quarters.

- Strong U.S. consumer spending on motor vehicles and parts boosted automotive exports. M&E exports increased by 9.0% after declining in the previous six quarters.

In contrast, imports growth slowed to 6.3%, down from 18.9% in the previous quarter.

- A slowdown in imports of M&E and services, partly offset a sharp increase in imports of auto parts.

**Real Exports and Imports of Goods & Services**



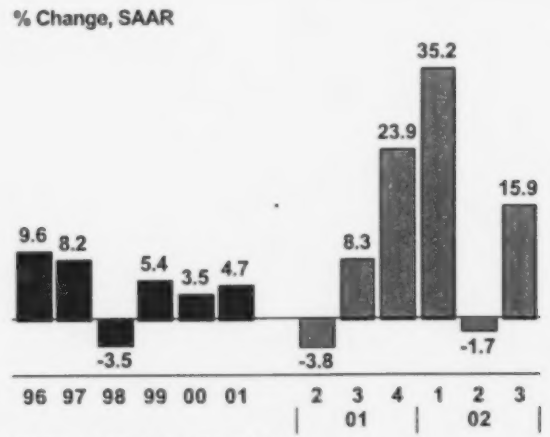

Source: Statistics Canada

## *...and housing activity rebounded*

**Residential investment jumped 15.9% in the third quarter, after declining 1.7% in the second quarter.**

- **Housing starts recovered to reach their highest level in a decade, while home construction increased by 7.2%.**

### Real Residential Construction Growth



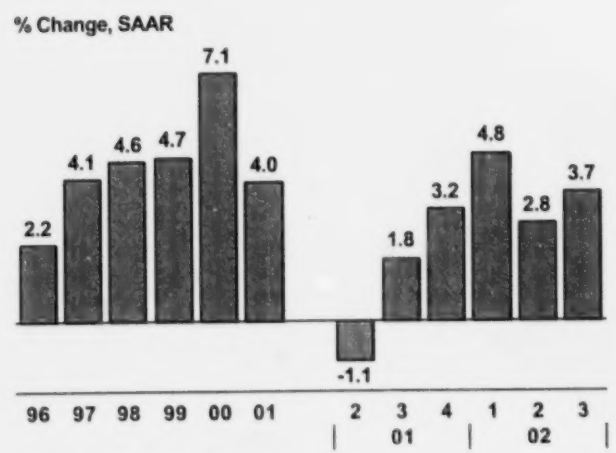

Source: Statistics Canada

# Domestic Scene

*Income Side*

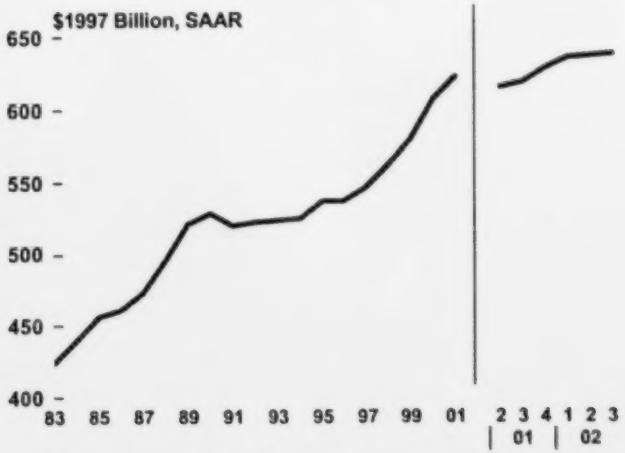
## *Personal disposable income growth slowed in the third quarter...*

### Growth in Personal Income




Source: Statistics Canada

### Real Personal Disposable Income*




*Converted to real dollars using the chain price index for personal expenditure on goods and services.
Source: Statistics Canada and Industry Canada

**Personal income rose at an annual rate of 3.7% in the third quarter, the fifth straight quarterly increase. Helped by the strong performance of the labour market, labour income continued to grow at a fast pace (5.1%). Unincorporated business income was also up substantially (10.3%) while investment income fell (-6.2%), largely reflecting low interest rates.**

**Personal disposable income rose by 4.1%, down from 4.5% in the second quarter. Similarly, real personal disposable income growth moderated to 0.7% from 1.0% in the second quarter.**

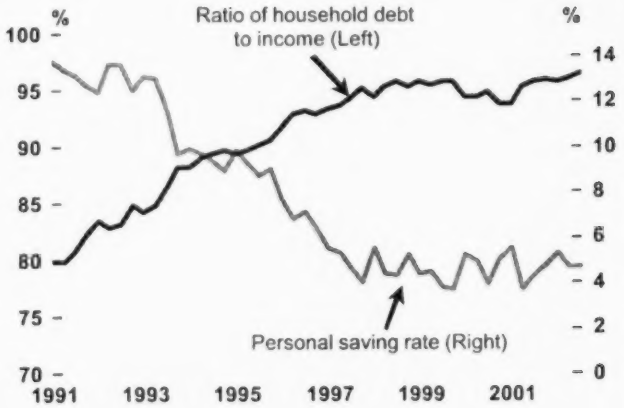
## *and the saving rate remained stable*

**Expenditures on consumer goods and services grew with personal disposable income, resulting in the personal savings rate to remain at 4.7%.**

**The household debt-to-income ratio increased 0.4 percentage point to 96.5%, as consumer credit and mortgage debt grew faster than personal disposable income.**

**The rise in debt-to-income ratio is not necessarily a cause for concern. Household assets have risen even faster than debt in recent years. Household net wealth (assets minus debt) went up from about four times personal disposable income in 1985 to nearly five times in 2001.**

### Personal Debt and Savings Rate




Source: Statistics Canada

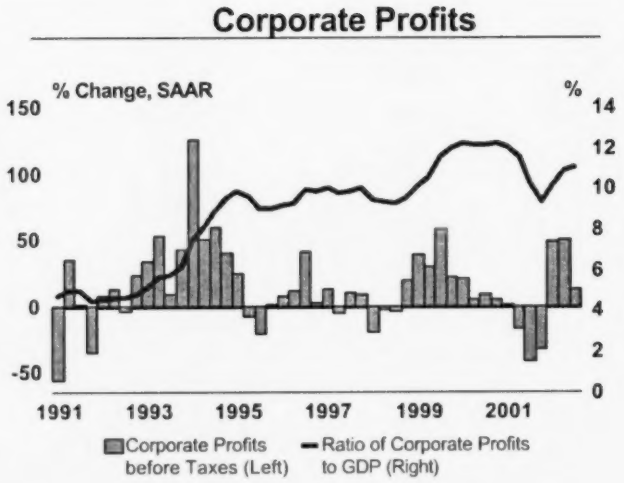
## *Corporate profits continued to rise*

**Corporate profits rose for the third straight quarter, but at a slower rate of 12.6% compared to 50% in the first half of 2002. Profits remained 3.9% below the peak reached in the first quarter of 2001.**

- **Strong exports stimulated profits in the manufacturing sector, especially in motor vehicles and parts.**

- **Profits decreased in the financial sector with a decline in profitability of the banking sector.**

**Meanwhile, the profit share of GDP increased further to 11.1% in the third quarter from 10.9% in the second quarter.**




Source: Statistics Canada

# Domestic Scene

## *Labour Situation*

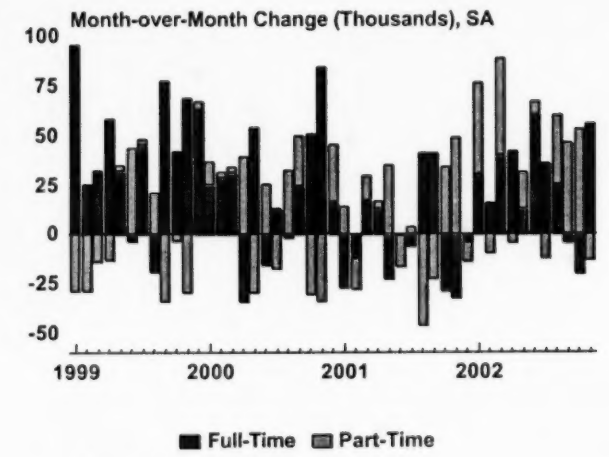
## *The labour market remained buoyant in November*

**In November, employment rose by 42 000 as full-time jobs surged 55 000, following cumulative losses of 25 000 for September and October.**

- **Year-to-date gains were 502 000, the largest number of jobs created for an eleven month period on record, and the fastest growth rate (+3.3%) for this period since 1987.**

**Job creation was split between full-time (+290 000 or 2.4%) and part-time (+212 000 or 7.7%) jobs in the first eleven months of 2002.**

**Employment Growth**




Source: Statistics Canada

**U.S. employment conditions have been weak. After increasing by only 6 000 in October, non-farm employment decreased by 40 000 in November. Moreover, U.S. manufacturing employment dropped by 45 000 in November, marking the 28th consecutive monthly decline. The unemployment rate went up 0.3 percentage point to 6.0% in November.**

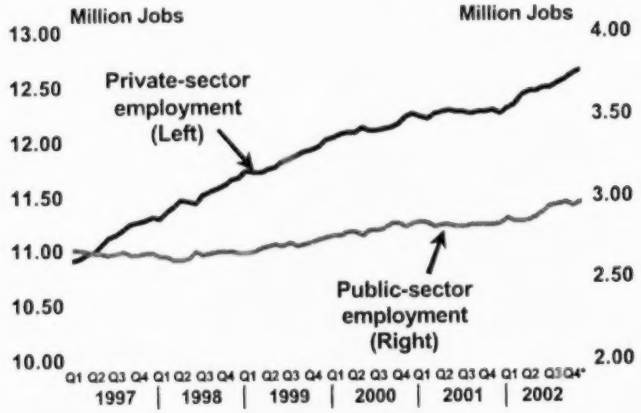
## *...with both private and public sectors recording strong increases*

**Led by a strong increase (+57 000) in paid employment, private sector employment rose by 25 000 in November. Helped by gains in the manufacturing sector, private sector employment rose by 280 000, or 3.1% in the January to November period.**

**The public sector created 17 000 jobs in November and year-to-date employment was up 123 000 or 4.3%. Public sector gains have been concentrated in education, health care, and social assistance.**

**Paid employment increased by 74 000 in November, pushing year-to-date gains to 402 000, or 3.1%. Despite 31 000 job losses in November, self-employment was up 4.3% in 2002 (+99 000), spurred by gains in professional and scientific services, agriculture and social services.**

### Employment: Private vs. Public




*Data for 2002Q4 includes October and November only.

Source: Statistics Canada

## *A large increase in the labour force kept the unemployment rate nearly unchanged at 7.5%*

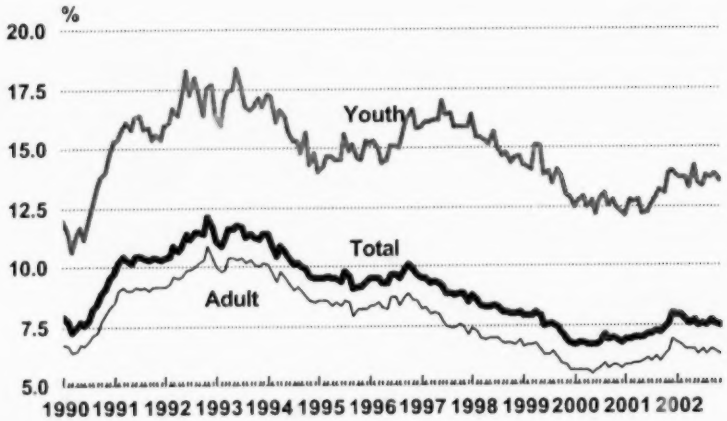
**The unemployment rate fell by 0.1 percentage point to 7.5% in November, down only 0.5 percentage point from its peak of 8.0% in December 2001.**

- **Better economic conditions have encouraged more Canadians to enter the labour force, offsetting in part the dampening effect of strong job creation on the unemployment rate.**

- **In November, the participation rate was at its highest level since 1990.**

**In November, 15 000 new jobs were created for youth, bringing total employment gains to 98 000 in 2002. The youth unemployment rate was 13.6%, down 0.3 percentage point from October. The adult unemployment rate fell slightly to 6.3%.**

**Unemployment Rates**




Source: Statistics Canada

## *All provinces, except Newfoundland & Labrador, benefited from strong job creation in 2002...*

**Ontario and Quebec, where most of the manufacturing sector is concentrated, accounted for 62.7% of employment gains in 2002, after their weak performance in 2001.**

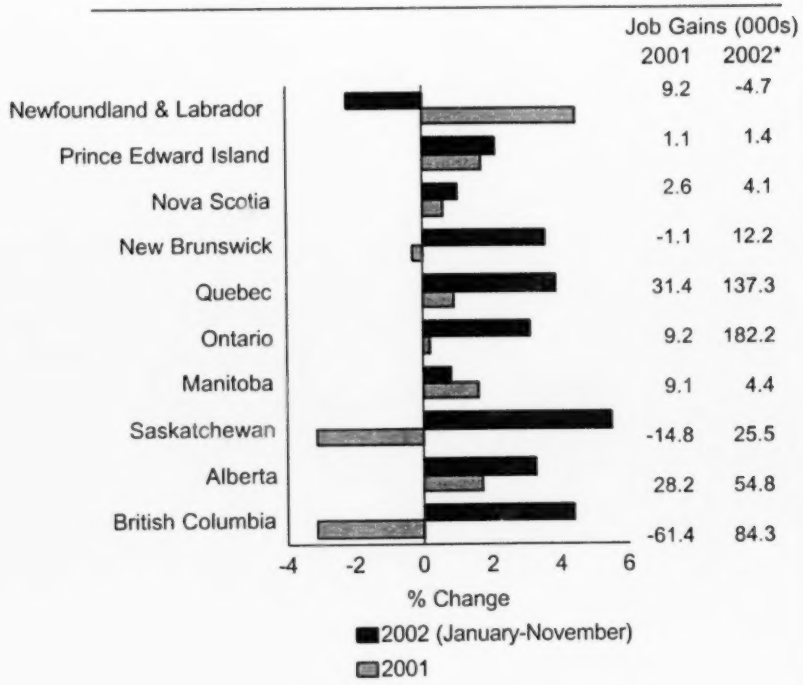
**After losing jobs in 2001, British Columbia (+84 300) and Saskatchewan (+25 500) posted strong turnarounds.**

**Compared to a year ago, Alberta created twice as many jobs (+54 800) during the January to November period.**

**Meanwhile, New Brunswick posted the largest job gains in Atlantic Canada, creating 12 000 new jobs.**

**Newfoundland was the only province posting job losses, following a strong performance in 2001.**

### Employment Growth by Province




*Figures for 2002 are year-to-date (January-November)
Source: Statistics Canada

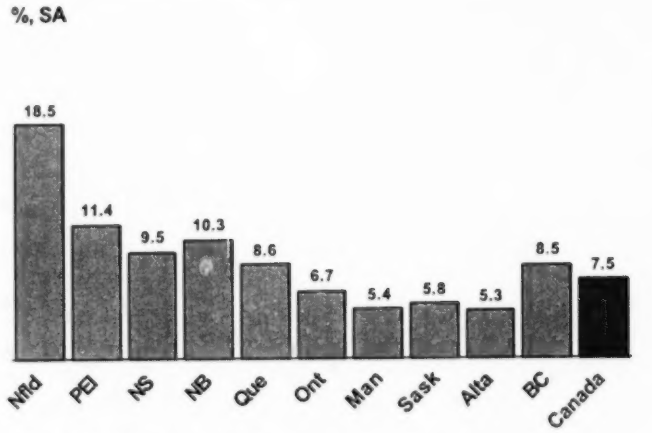
## *...resulting in the unemployment rate falling in most provinces*

**The unemployment rate in November was lower everywhere relative to December 2001, except in Newfoundland & Labrador (+1.5 percentage points to 18.5%) and Manitoba (+0.8 point to 5.4%).**

**The most notable declines in the unemployment rate were in British Columbia (-1.2 percentage points to 8.5%), and Quebec, New Brunswick and Prince Edward Island (1.1 percentage point declines).**

**Other provinces registered smaller declines compared to the 0.5 percentage point decrease at the national level.**

### Unemployment Rates: November 2002




Source: Statistics Canada

# Domestic Scene

*Sectoral Overview*

# *Output rose in most industries in the third quarter*

Output in the Goods-producing industries rose by 3.5% (annual rate) in the third quarter of 2002, following revised increases of 9.3% and 5.8% in the previous two quarters.

- In the Manufacturing sector, real GDP continued to grow at a healthy pace in the third quarter, helped by strong exports of motor vehicles.

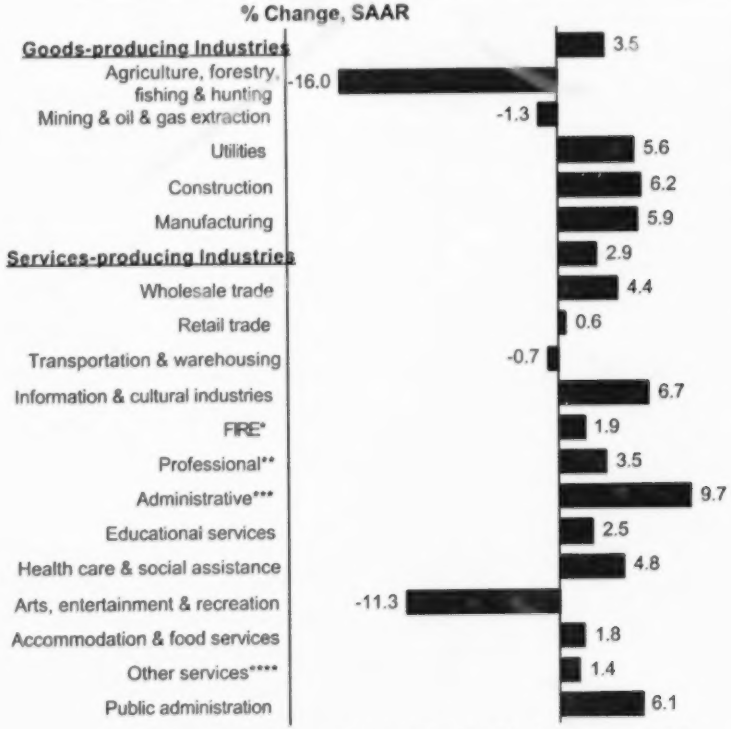
- Robust consumer demand for new houses continued to raise output in the Construction sector and its feeder industries. However, a large decline in the Agriculture, Forestry, Fishing & Hunting sector offset gains recorded the previous quarter as the drought hurt agriculture. Warm weather boosted demand for electricity which led to higher Utilities output.

Output in the Services-producing industries was up 2.9% in the third quarter.

- Most sectors recorded gains. The highest gains were registered by Administrative and Information & Cultural industries. After posting strong growth in the second quarter, the Arts, Entertainment & Recreation sector (which makes up only 1.5% of total services output) recorded an 11.3% decline in output.

Overall, real GDP at basic prices rose 3.1% in the third quarter following a rise of 3.9% in the second. Most gains occurred in July as output growth moderated in August and September.

## Real GDP Growth by Industry: 2002Q3




* Includes Finance & insurance, real estate & renting & leasing & management of companies & enterprises
** Includes Professional, scientific & technical services
*** Includes Administrative & support, waste management & remediation services
**** except public administration

Source: Statistics Canada

E-1

# *Corporate operating profits continued to expand, but at a slower pace*

**Corporate operating profits rose by 2.6% in the third quarter, down from an average growth of 11.1% in the first two quarters.**

**Spurred by rising shipments, Manufacturers' profits rose for the fourth consecutive quarter, driven by strong gains in the automotive industry. In contrast, the prolonged slump continued in the high-tech sector, with operating losses totalling $0.2 billion.**

**Retailers continued to benefit from low interest rates and the strong job market as their profits surged 8.5% in the third quarter. Transportation & Warehousing profits increased for the fourth straight quarter following the aftermath of the September 11th events.**

**Profits of financial industries edged down 1.4% to $8.1 billion, following gains of 7.1% and 5.3% in the first two quarters of 2002. The Depository Credit Intermediaries led the decline as profit dropped 11.0%. Profits of Funds and Other Financial Vehicles companies fell for the third consecutive quarter, due mostly to losses on securities sales.**

## Corporate Operating Profits

| | 2002Q3 Level ($M) | Difference 02Q2-02Q3 ($M) | 02Q2-02Q3 (%) | 01Q3-02Q3 (%) |
|---|---|---|---|---|
| **Total - All Industries** | 40,284 | 1,019 | 2.6 | 12.9 |
| **Total Non-Financial** | 32,151 | 1,137 | 3.7 | 22.8 |
| Agriculture, forestry, fishing & hunting | 363 | 3 | 0.8 | -30.7 |
| Mineral fuels | 4,318 | -40 | -0.9 | 3.1 |
| Mining except mineral fuels | 378 | 55 | 17.0 | -36.0 |
| Utilities | 615 | -199 | -24.4 | -46.0 |
| Construction | 841 | -52 | -5.8 | -6.8 |
| Manufacturing industries | 11,009 | 1,002 | 10.0 | 46.4 |
| Wholesale trade industries | 2,747 | 74 | 2.8 | 17.2 |
| Retail trade industries | 2,487 | 195 | 8.5 | 76.3 |
| Transportation and warehousing | 2,056 | 172 | 9.1 | 101.0 |
| Information and cultural industries | 1,928 | 29 | 1.5 | 9.7 |
| Real estate, rental and leasing | 2,735 | -48 | -1.7 | 5.8 |
| Professional/Scientific | 636 | -48 | -7.0 | 32.8 |
| Management of companies | 2,980 | -153 | -4.9 | -24.7 |
| Other services to business | 537 | -122 | -18.5 | 13.8 |
| Education services | -45 | 3 | -6.3 | -27.4 |
| Health care and social assistance | 386 | 5 | 1.3 | 2.9 |
| Arts, entertainment and recreation | 129 | 35 | 37.2 | 57.3 |
| Accommodation and food services | 701 | 76 | 12.2 | 21.5 |
| Other services | 330 | -3 | -0.9 | 23.1 |
| **Total Financial** | 8,132 | -119 | -1.4 | -14.4 |
| Depository credit intermediation | 2,953 | -366 | -11.0 | -28.7 |
| Non-depository credit intermediation | 1,288 | -23 | -1.8 | -7.7 |
| Insurers | 1,242 | 448 | 56.4 | 2.6 |
| Funds and other financial vehicles | -3,727 | -2,732 | 274.6 | 474.3 |
| Other financial intermediaries | 2,650 | -177 | -6.3 | -3.5 |

Source: Statistics Canada

## *Manufacturing and Community Services accounted for almost 60% of all jobs created in 2002...*

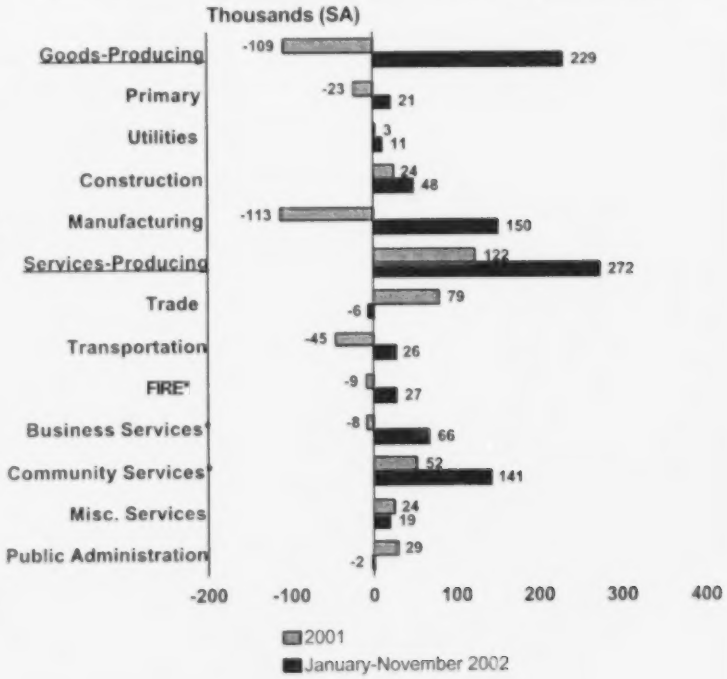
**Employment in the Goods sector is up 229 000 over the first eleven months of 2002, more than offsetting job losses (-109 000) in 2001.**

- **The manufacturing sector created 150 000 jobs in the first eleven months of 2002. Despite losses in November (-16 000), employment in construction was 5.7% higher than its December 2001 level.**

**In the Services industries, 272 000 jobs were created over the January to November period, with most sectors reporting employment gains.**

- **Community services has been an area of strength with educational services and health & social assistance recording solid gains. Trade and public administration have recorded marginal losses.**

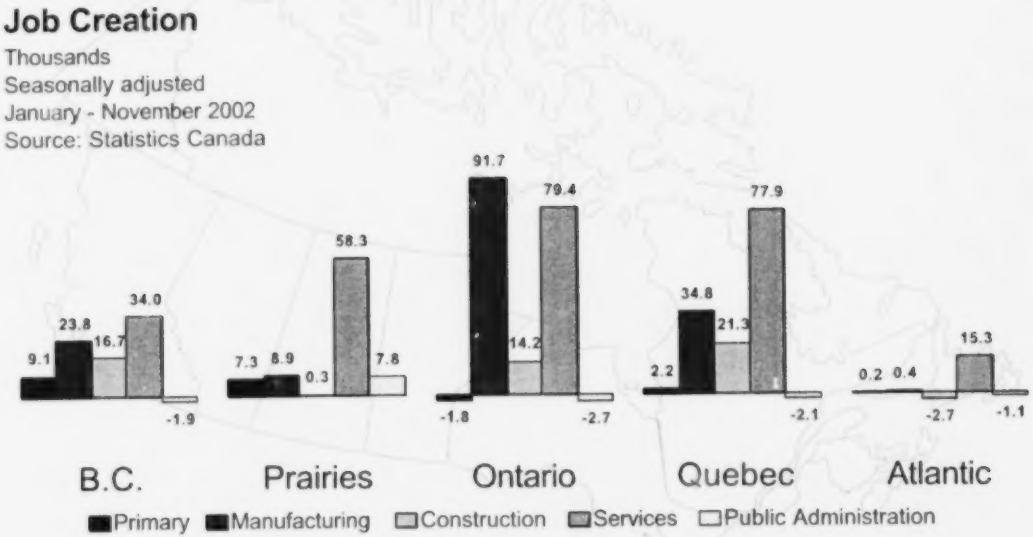
### Job Growth by Industry




*FIRE: Finance, Insurance, Real Estate and Leasing
Business Services: Management, Administrative, Professional, Scientific & Technical Services
Community Services: Educational Services, Health & Social Assistance

Source: Statistics Canada

## *...with gains concentrated in Ontario and Quebec*




**On a year-to-date basis, Manufacturing employment increased in all regions, with Ontario (+92 000) accounting for 60% of all jobs created. Primary sector employment was also, especially in Western Canada, driven by gains in agriculture. Construction employment grew in all regions, except the Atlantic.**

**Employment gains in Services were widespread with Ontario and Quebec reporting the largest increases. Meanwhile, employment in public administration fell everywhere, but the Prairies.**

# *Wage settlements moderated, but real wage growth increased in 2002*

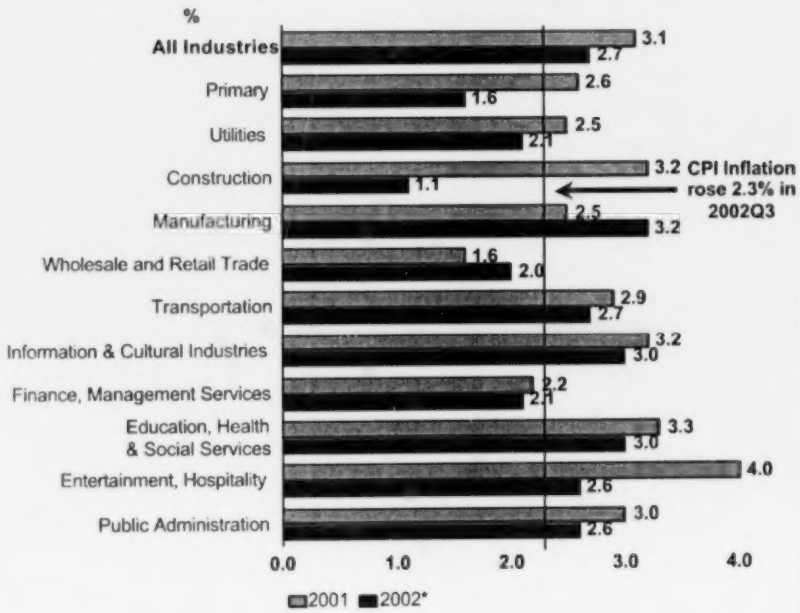
**Wage settlements averaged 2.7% in the first nine months of 2002, down from 3.1% in 2001. However, over the same period, Consumer Price Index (CPI) inflation dropped to 2.0% from 2.6% in 2001, leading to a slightly better gain in real wages in 2002 (0.7% versus 0.5% in 2001).**

- **Reflecting strong employment demand, wage settlements were the highest in the manufacturing sector.**

- **Settlements in six of eleven industry groups were above the CPI inflation.**

**The Public sector (+2.8%) wage settlements continued to outpace those in the Private sector (+2.4%) for the January to September period.**

## Wage Settlements by Industry




Effective average annual adjustments in base wage rates from major collective bargaining agreements.
*2002 data cover agreements reached over the January to September period.

Source: Human Resources Development Canada

# *Capacity utilization continued to increase in the third quarter*

**Capacity utilization rose by 0.8 percentage point to 83.3% in the third quarter, the third consecutive quarterly increase. Capacity use was higher than its 10-year average, but remained below its peak of 85.5% reached in the third quarter of 2000.**

**Capacity use in the Electric power industry rose sharply in response to increased demand for electricity, due to warm weather in the summer. Higher demand for new dwellings contributed to capacity use increase in Construction and wood products. Lower production in Mining pushed down capacity use in Mining & Oil & Gas Extraction well below its 10-year average.**

**Within Manufacturing, capacity utilization rose in 16 of the 21 groups, propelled by strong exports and sustained activity in the construction industry.**

- **U.S. demand for paper products contributed to the capacity use increase in the Paper industry, the highest rate since 1994. Strong North American demand for motor vehicles and heavy trucks also boosted capacity use in Transportation Equipment.**

## Capacity Utilization: Non-farm Goods-producing Industries

| | Level (%) 2002Q3 | Change (% points) Q/Q | Change (% points) Y/Y | 10-year Average |
|---|---|---|---|---|
| Total industrial | 83.3 | 0.8 | 2.5 | 82.4 |
| Forestry & logging | 80.1 | -1.2 | 4.5 | 80.6 |
| Mining & oil & gas extraction | 70.7 | -0.6 | -5.0 | 78.8 |
| Electric power * | 90.7 | 2.4 | 5.0 | 83.9 |
| Construction | 86.8 | 0.5 | 0.8 | 82.0 |
| Total Manufacturing | 84.6 | 1.1 | 4.4 | 83.3 |
| Food | 82.2 | -0.1 | 0.9 | 80.7 |
| Beverage & tobacco products | 77.3 | 0.7 | -0.5 | 80.4 |
| Textile mills | 81.3 | 0.2 | 1.5 | 83.2** |
| Textile product mills | 86.4 | 2.0 | 7.6 | 80.4** |
| Clothing | 86.6 | 0.6 | 5.3 | 82.9 |
| Leather & allied products | 76.6 | 1.4 | -0.7 | 74.6 |
| Wood products | 96.2 | 0.9 | 14.3 | 86.8 |
| Paper | 94.6 | 3.4 | 7.1 | 90.3 |
| Printing & related support activities | 72.7 | -2.1 | -2.5 | 77.9 |
| Petroleum and coal products | 97.3 | 0.0 | 2.4 | 92.3 |
| Chemical | 84.0 | 1.7 | 7.5 | 82.4 |
| Plastic & rubber products | 90.3 | 1.9 | 10.1 | 83.6 |
| Non-metallic mineral products | 82.5 | 0.8 | 7.2 | 77.7 |
| Primary metal | 91.2 | 0.9 | 5.8 | 89.9 |
| Fabricated metal products | 83.8 | 0.5 | 2.9 | 80.1 |
| Machinery | 83.1 | 2.4 | 4.2 | 80.7 |
| Computer & electronic products | 65.0 | -1.1 | -4.5 | 80.2 |
| Electrical equipment | 68.9 | -1.3 | -3.8 | 82.9 |
| Transportation equipment | 91.3 | 3.0 | 6.6 | 85.0 |
| Furniture & related products | 80.6 | 1.3 | 3.8 | 80.7 |
| Miscellaneous manufacturing | 84.7 | 0.7 | 4.6 | 82.1 |

* Electric power generation, transmission & distribution
** Represents data available between 1997Q2-2002Q3
Source: Statistics Canada

# Domestic Scene

***Productivity & Competitiveness***

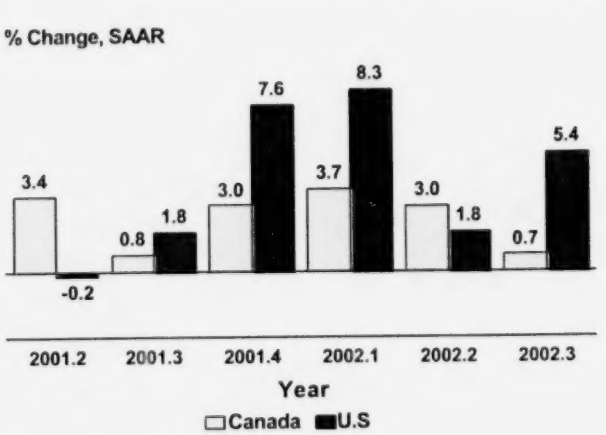
## *Productivity growth moderated in the third quarter...*

**Labour productivity in the business sector increased by 0.7% (annual rate) in the third quarter, down sharply from increases of 3.0% or more in the previous three quarters.**

- **This slowdown reflected a moderation in output growth, together with an acceleration in hours worked due to strong employment performance.**

**In comparison, U.S. labour productivity growth rebounded in the third quarter to 5.4% from 1.8% in the previous quarter. The rebound reflected an acceleration in output (5.2%) and a small decline in hours worked, as employers remained reluctant to increase their workforce.**

**Productivity Growth**



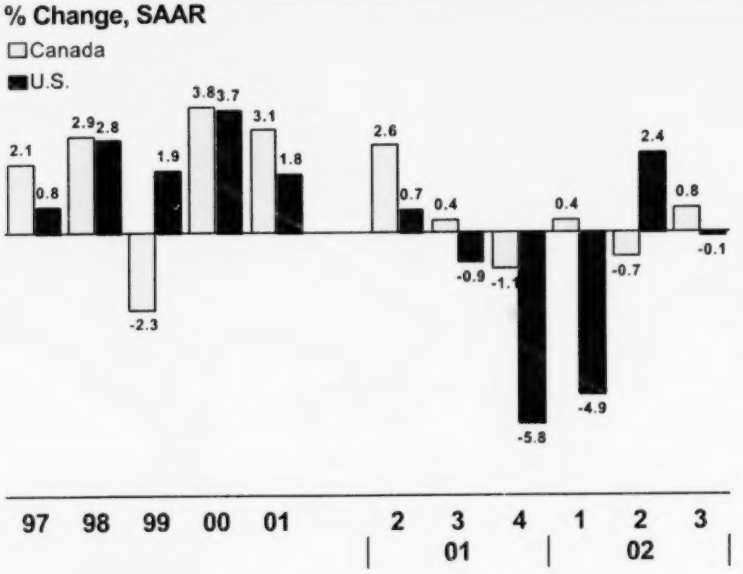

Source: Industry Canada calculations

## *...driving unit labour costs up*

**Unit labour costs increased 0.8% (annual rate) in the third quarter, their largest increase since the second quarter of 2001.**

**In the U.S., unit labour costs edged down 0.1% in the third quarter as productivity increased at a faster pace than wages.**

**Growth in Unit Labour Costs***



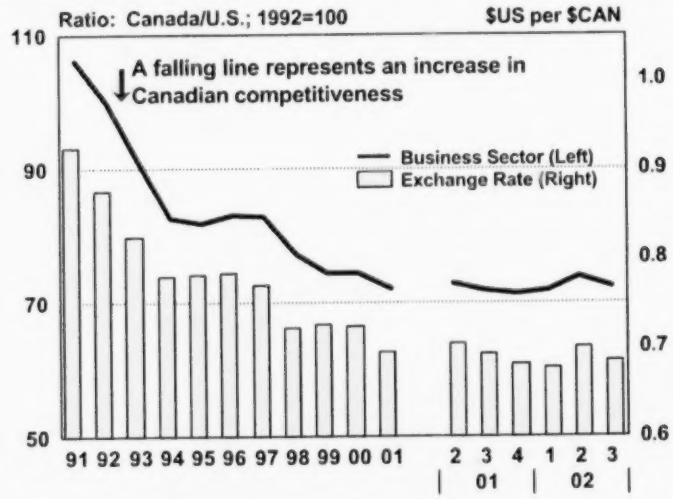

* For the business sector
Source: Statistics Canada, Bureau of Labor Statistics and Industry Canada calculations.

## *Nonetheless, Canadian firms competitiveness improved*

**Canadian firms competitiveness relative to their U.S. counterparts improved in the third quarter, recovering losses posted earlier in the year.**

- **This was due to a weaker Canadian dollar relative to the greenback, as it fell from US$0.65 in the second quarter to US$0.63 in the third quarter.**

**Unit Labour Cost Comparison ($US)**




Source: Industry Canada calculations based on data from the U.S. Bureau of Labor Statistics and Statistics Canada

# Domestic Scene

*International Accounts*

## *The Current account surplus increased in the third quarter...*

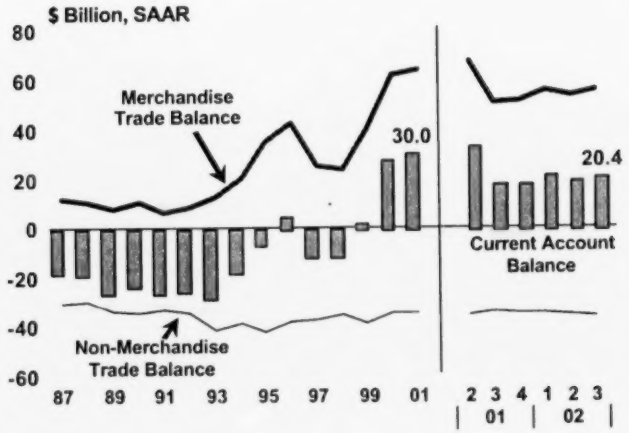
**Canada's current account surplus rose by $0.4 billion to $5.1 billion ($20.4 billion annualized) in the third quarter, mostly attributable to a higher merchandise trade surplus.**

**Canadians increased their investments in foreign countries from $11.8 billion in the second quarter to $13.1 billion in the third quarter. Meanwhile, foreign investment plunged to $4.6 billion from $10.7 billion in the second quarter.**

- **At $12.8 billion, Canadian direct investment abroad increased $4.2 billion from its second quarter level. Most of the investment went to affiliates for working capital with little going to new acquisitions. Economic uncertainty slowed direct investment to the U.S., a break from the past four years which has seen most investment go there.**

- **Foreign direct investment of $1.6 billion flowed into Canada in the third quarter, the lowest level in seven years.**

### Current Account & Trade Balances




The merchandise trade balance represents net exports of goods.

The non-merchandise trade balance represents net exports of services plus net receipts of investment income and transfers.

Source: Statistics Canada

## *...largely reflecting a rise in the merchandise trade surplus...*

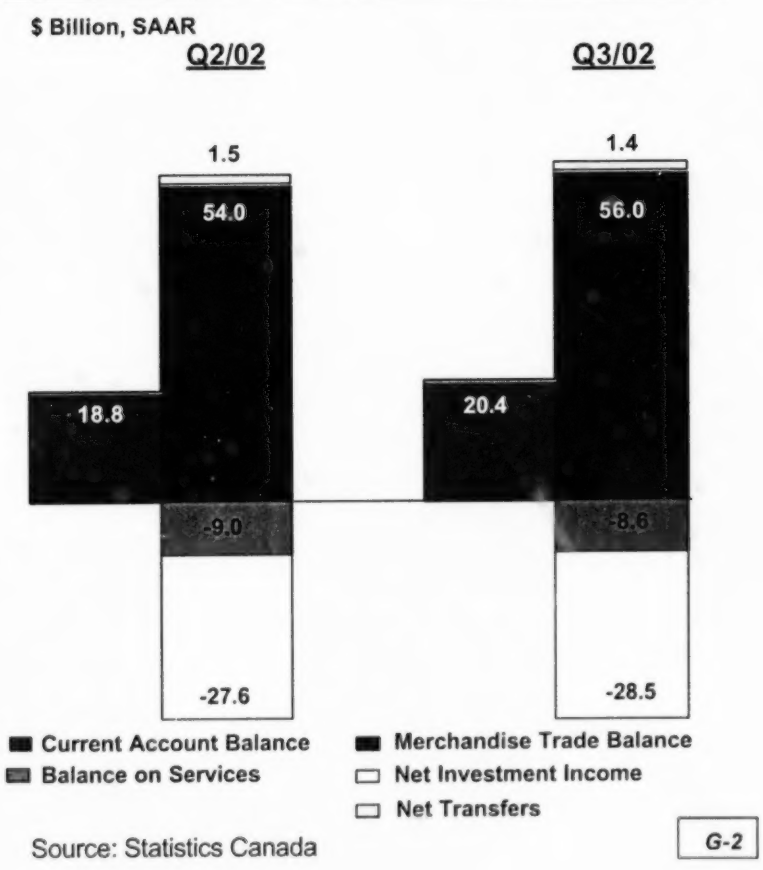
The merchandise trade surplus increased by $0.5 billion to $14.0 billion ($56.0 billion annualized) in the third quarter, as exports grew faster than imports.

- The goods surplus with the U.S. rose for a third consecutive quarter, mainly due to automotive and energy sector products.

The deficit on services dropped from $2.2 billion in the second quarter to $2.1 billion ($8.6 billion annualized) in the third quarter, largely due to a smaller commercial services deficit.

After declining in the first and second quarters, the deficit on investment income increased as a result of lower profits from investment abroad.

### Main Components of the Current Account




Source: Statistics Canada

G-2

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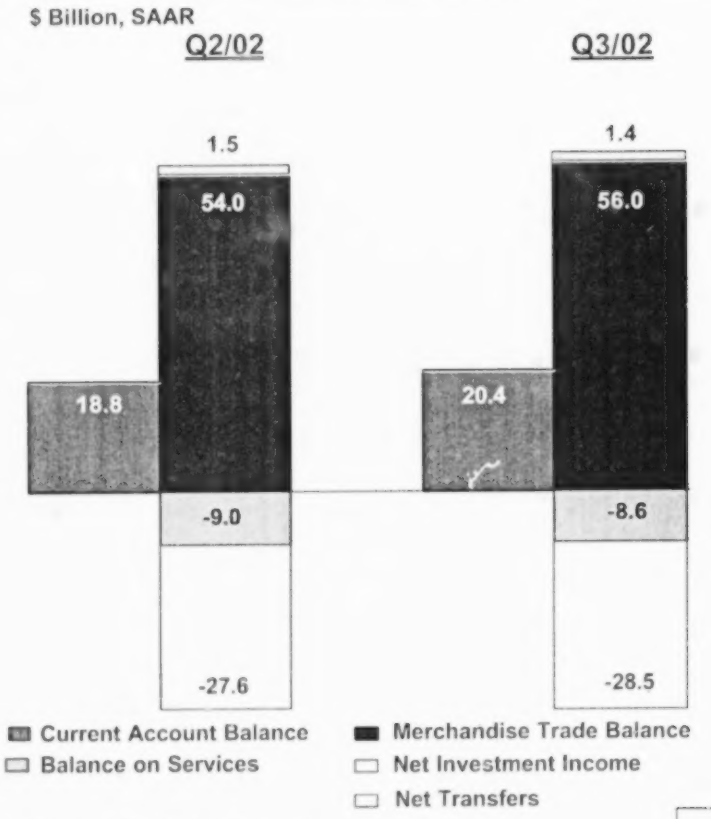



Source: Statistics Canada

## *...resulting from higher growth in exports...*

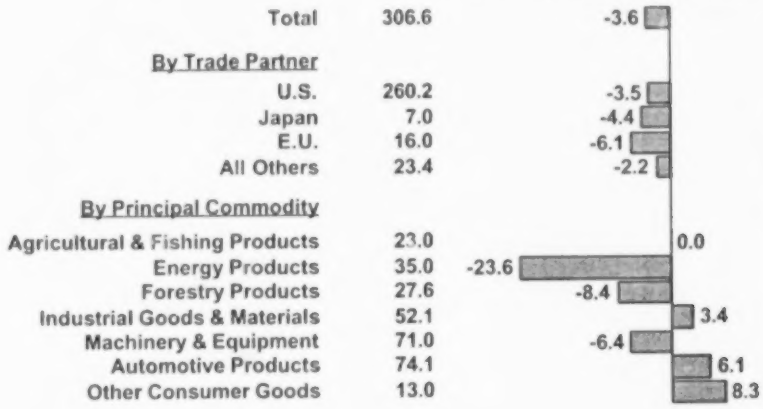
Merchandise exports continued to rise in the third quarter (+2.9%), following a gain of 2.4% in the second quarter. Despite the increases, total exports for the first nine months of the year were down compared to the same period in 2001.

- Automotive products (+6.5%) and Other Consumer Goods (+6.7%) were the main contributors to export growth in the third quarter.
  The impact of U.S. anti-dumping measures took its toll on exports of forestry products (-3.0%), the only sector suffering a decline.

On a year-to-date basis, Energy product exports faced a notable decline (-23.6%), as did Forestry products (-8.4%) and Machinery and Equipment (-6.4%).
The geographic decline was widespread with exports to the U.S. down 3.5% and exports to the European Union down 6.1%.

### Merchandise Exports, 2002Q3

| | $ Billion | % Change Jan.-Sept./01 - Jan.-Sept./02 |
|---|---|---|
| Total | 306.6 | -3.6 |
| By Trade Partner | | |
| U.S. | 260.2 | -3.5 |
| Japan | 7.0 | -4.4 |
| E.U. | 16.0 | -6.1 |
| All Others | 23.4 | -2.2 |
| By Principal Commodity | | |
| Agricultural & Fishing Products | 23.0 | 0.0 |
| Energy Products | 35.0 | -23.6 |
| Forestry Products | 27.6 | -8.4 |
| Industrial Goods & Materials | 52.1 | 3.4 |
| Machinery & Equipment | 71.0 | -6.4 |
| Automotive Products | 74.1 | 6.1 |
| Other Consumer Goods | 13.0 | 8.3 |



Source: Statistics Canada

## ...than imports

Merchandise imports rose 2.7% in the third quarter, following an increase of 3.2% in the second quarter. Total imports for the first nine months of this year are only slightly below their 2001 levels for the same period.

- Increases in imports were reported across all principal commodity groups in the third quarter, with the largest gains in Energy products (+6.5%), Agricultural and Fishing products (+6.1%), and Automotive products (+5.8%).

- On a year-to-date basis, notable increases were recorded for imports of automotive, other consumer goods, and agricultural & fishing products, offsetting declines in imports of energy products and M&E.

### Merchandise Imports, 2002Q3

| | $ Billion | % Change Jan.-Sept./01 - Jan.-Sept./02 |
|---|---|---|
| Total | 265.2 | -0.6 |
| By Trade Partner | | |
| U.S. | 190.7 | -1.9 |
| Japan | 8.7 | 10.0 |
| E.U. | 26.7 | 1.4 |
| All Others | 39.2 | 2.3 |
| By Principal Commodity | | |
| Agricultural & Fishing Products | 16.3 | 8.2 |
| Energy Products | 11.8 | -17.9 |
| Forestry Products | 2.3 | 7.5 |
| Industrial Goods & Materials | 51.5 | -1.2 |
| Machinery & Equipment | 79.0 | -8.9 |
| Automotive Products | 60.6 | 11.7 |
| Other Consumer Goods | 34.4 | 7.1 |

Source: Statistics Canada

# Domestic Scene

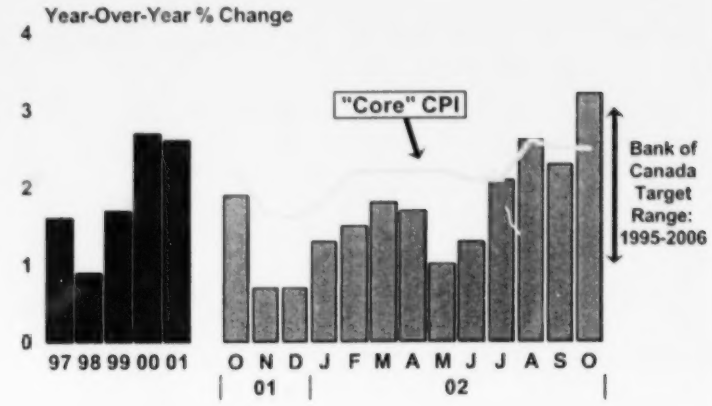
***Price Movements***

# *CPI inflation rose further in October, while core inflation remained steady*

**Inflation, as measured by the year-over-year change in the CPI, rose to 3.2% in October from 2.3% in September and up sharply from a low of 1.0% in May.**

**"Core" inflation – which excludes the most volatile components of the overall CPI and indirect taxes, and is the target for monetary policy – was steady at 2.5% between August and October. This was above the midpoint of the official 1-3% target range.**

## Consumer Price Index




In May 2001, the Bank of Canada and the Finance Department announced the renewal of the inflation target for monetary policy until 2006. The Bank also refined its measure for the underlying trend in inflation as measured by "core" inflation.
The "Core" CPI excludes prices for: fruit, fruit preparations and nuts; vegetables and vegetable preparations; gasoline; fuel oil; natural gas; mortgage interest; inter-city transportation; and tobacco products. It also excludes the effect of changes in indirect taxes.

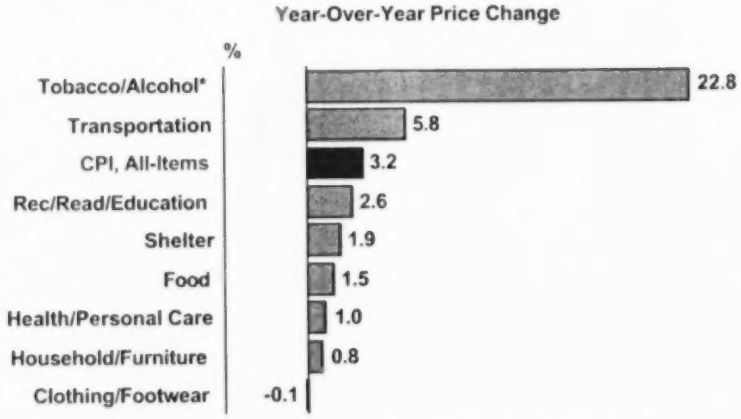
Source: Statistics Canada & Bank of Canada

## *Energy prices jumped in October, their first year-over-year increase in one year*

**The rise in inflation was in part due to energy prices which jumped 5.6% in October, after declining in the previous 12 months.**

**Increases in transportation, shelter and tobacco prices also contributed to higher inflation.**

### Components of CPI: October 2002




* Increases in sales taxes on cigarettes, the most recent in June, have pushed the Tobacco & Alcohol price index higher. As a result, the year-over-year rise in the index has averaged 16.7% since November 2001, when the sequence of tax increases began.

Source: Statistics Canada

## *Helped by a rising demand, prices of manufactured products and raw materials continued to increase from their lows of last December*

**Industrial product prices – those received by producers at the factory gate – rose by 2.4% in October, the third consecutive year-over-year increase.**

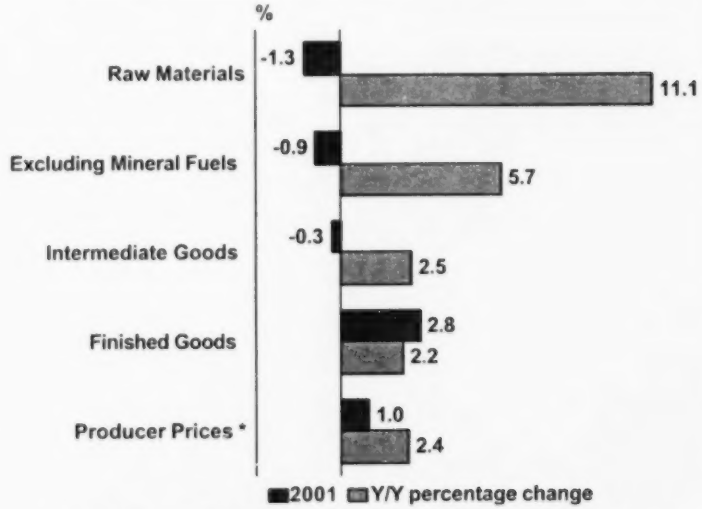
- **Besides the 8.5% increase in petroleum and coal products prices, higher prices for wood, food and primary metals also contributed to the increase.**

**Following several declines, the prices of intermediate goods (used by other manufacturers to produce final goods) rose by 2.5% in October, the largest year-over-year increase since January 2001.**

**The prices of raw materials jumped 11.1% on a year-over-year basis, up from 5.5% in September.**

- **The rise was mainly indicative of a jump in crude oil prices. Excluding mineral fuels, the index was up 5.7%, the largest rise in a string of five straight increases.**

### Price Chain - October 2002




* Producer prices and the exchange rate effect: Because some Canadian exporters quote their prices in U.S. dollars - particularly for motor vehicles, pulp, paper and wood products - changes in the exchange rate between the Canadian and the U.S. currencies affect producer prices. A depreciation in the Canadian dollar pushes producer price inflation up and vice versa.

Source: Statistics Canada

# Domestic Scene

*Financial Variables*

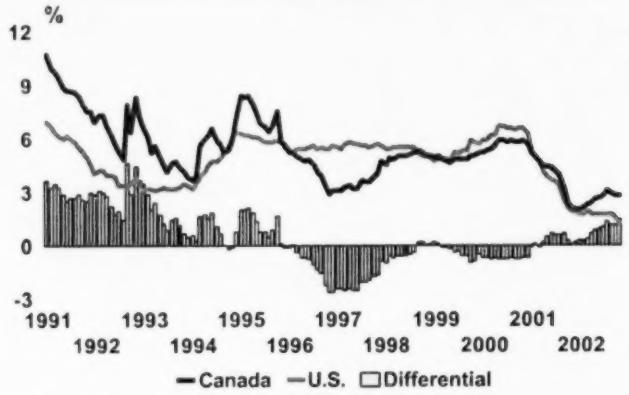
## *Credit conditions remain accommodative as financial and geopolitical uncertainty inhibit global economic recovery*

**On December 3rd, the Bank of Canada kept its target for the overnight rate unchanged at 2.75%, indicating that economic growth had been coming in lower than previously expected, due to financial and geopolitical uncertainties.**

**In the United States, the Federal Reserve reduced its Federal Funds rate by half a percentage point to 1.25% on November 6th, and left it unchanged at its meeting on December 10th. This reduction came in light of economic data pointing to softening activity and concerns about heightened geopolitical risks.**

**In line with these developments, the spread between money market rates in Canada and the U.S. reached 152 basis points on December 4th, the largest difference since August 1993.**

### Short-Term Interest Rates




Last data point plotted: December 4, 2002

Source: Bank of Canada, 90-day Commercial Paper, last Wednesday in the month

**2003 interest rate setting dates**

| Canada | United States |
|---|---|
| January 21 | January 28-29 |
| March 4 | March 18 |
| April 15 | May 6 |
| June 3 | June 24-25 |
| July 15 | August 12 |
| September 3 | September 16 |
| October 15 | October 28 |
| December 2 | December 9 |

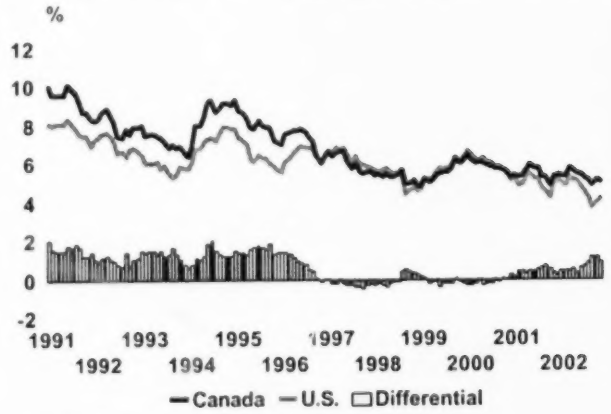
## *North American long-term interest rates trended downward*

**Long-term yields fell in the third quarter as increasing geopolitical turmoil in the Middle East led investors to switch funds into the fixed income market. In early October, the 10-year Canadian bond yield dropped to a low of 4.8% (the lowest since October 1998) and the U.S. 10-year benchmark yield fell to a low of 3.6%.**

**However, since mid-October, improving investor confidence fuelled an outflow of funds from the fixed-income market towards stocks, pushing long-term interest rates up. Nonetheless, long-term interest rates were still well below their levels at the beginning of 2002.**

**The spread between Canadian and U.S. long-term interest rates reached 1.2 percentage points in October, the highest since April 1996. It has hovered around 100 basis points since the beginning of November.**

### Long-Term Interest Rates




Last data point plotted: December 4, 2002

Source: Bank of Canada, 10-year Government bond, last Wednesday in the month

## *Equity markets rebounded on improving investor sentiment*

**Encouraged by positive third quarter earnings announcements, investors started buying on expectations of a recovery in corporate activity. Technology stocks, battered in the last couple of years, made significant gains, as reflected in the NASDAQ index surging about 25% between early October to mid-December.**

- **The S&P/TSX index dropped to a low of 5 695 in October before regaining about 1 000 points to close out at 6 724 on December 16th. Meanwhile, the S&P 500 index rose to 918 from its low of 776 reached on October 9th.**

**Stock Market Indices**

Last data point plotted: December 5, 2002

* On May 1st, Canada's main equity index was renamed the Standard & Poor/Toronto Stock Exchange index (S&P/TSX).

Source: Statistics Canada

## *The Canadian dollar recovered to over 64 cents in December*

**The Canadian dollar closed at US64.1¢ in mid-December, up from a recent low of US63.0¢, but still down from its peak in July.**

- **On the upside, the Canadian dollar benefited from higher Canadian interest rates than the U.S. rates, as well as stronger economic conditions and some strengthening in non-energy commodity prices.**

- **On the downside, the uncertainty on the geopolitical front and the weakness in the global economy induced investors to seek the safety of the U.S. dollar.**

### Canada-U.S. Exchange Rate

Last data point plotted: December 4, 2002

Source: Bank of Canada

# Domestic Scene

*Fiscal Track*

## *The federal government recorded its fifth straight surplus*

**For the 2001-02 fiscal year, the federal government posted a budgetary surplus of $8.9 billion.**

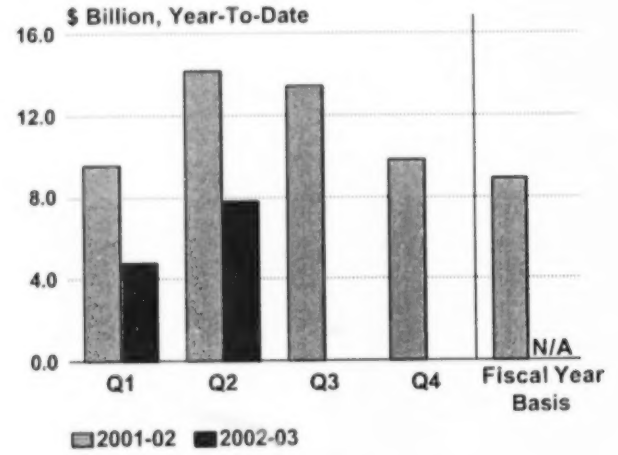
- **The surplus was $7.4 billion higher than forecasted in the December 2001 budget, indicating lower than estimated program spending, lower public debt charges and higher than expected budgetary revenues. This helped reduce the net debt-to-GDP ratio to 49.1%, down from a peak of 70.9% in 1995-96.**

**Over the first six months of fiscal year 2002-03, the federal government posted a surplus of $7.8 billion, compared to a surplus of $14.2 billion reported for the same period last year.**

- **The lower surplus reflects smaller budgetary revenues and higher program spending. Smaller budgetary revenues can be attributed to lower final tax payments and higher refunds with respect to the 2001 tax year, caused by weakness in the stock market and lower corporate profits.**

**All provinces, except B.C., P.E.I. and Nlfd & Lab., are still expected to record balanced budgets or surpluses in 2002-03, while the three territories should post deficits.**

**Federal Budgetary Balance**




Source: Department of Finance

## *For Further Information*

We welcome your questions, comments and suggestions? You can reach us by ...


| | |
|---|---|
| *sending us a letter:* | Hossein Rostami<br>Director<br>Micro-Economic Analysis<br>Industry Canada<br>235 Queen Street, Room 540G<br>Ottawa, Ontario K1A 0H5 |
| *e-mailing:* | rostami.hossein@ic.gc.ca |
| *phoning:* | (613) 995-8452 |
| *or faxing us at:* | (613) 952-1936 |


The *Micro-Economic Monitor* is prepared on a quarterly basis by the Micro-Economic Policy Branch of Industry Canada. The Monitor provides a quick and easy-to-read update on Canada's economic performance. It also provides topical in-depth reports on current economic issues from a micro-economic perspective. This report uses data available as of December 16, 2002.


The current analysis update was prepared by Marianne Blais, Jenness Cawthray, Stéphane Crépeau, Anik Dufour, Kevin Koch, Joseph Macaluso, Arif Mahmud, Sue Moore, François Poitras, Patrick Taylor under the direction of Hossein Rostami and François Poitras. Translation has been provided by Lucie Larocque, and Sue Hopf is responsible for administrative support.



ISSN 1206-260X